



# New Developments in Contract Relationships in the Swine Industry

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# Contracts at the Production and Marketing Phase are Evolving

Coordination of the Chain  
Continues

## Forces Encouraging Coordination

- Branding of Various Kinds to Capture Consumer Surplus and Overcome Destructive Cost Competition as Only Viable Strategy
- Traceability as a both a Legal and Branding Requirement
- Critical Mass for Up-Chain Negotiation
- Food Safety/Bio-Terrorism Issues
- Emerging Animal Welfare Issues
- Co-Permitting Threats

# Production Contracts

- Building Costs Rising Dramatically
  - China and India Factor
  - Dollar Value
  - Housing Market
  - Hurricanes
- Interest and Permitting Costs Rising
  - Economy Growing Rapidly
  - Inflation Worries Encourage Incremental Increases in Rates
  - Terms Extending to 12-15 Years from 10
- Energy Costs Rising
  - Real Costs Expected to Stabilize and Move Downward
  - Propane price (a by-product) is highly volatile
- Contract Terms
  - Changing to Match Extended Financing
- Satisfaction by Growers High (4.9 on 6.0 Scale)
  - 2003 Univ of MO et al Study
- Procedures Changing to Accommodate New Demands by Government and Market Branding Requirement

# Marketing Contracts

- 10% Sold on Negotiated Market (likely long-term equilibrium)
- Contract Terms Differentiated on Packer Strategy (Meat vs. Food)
- Moving to a Whole Chain Pricing Formula to Establish a Rational Investment Environment for the Chain (Paradigm Change: From Pigs to Meat to Food)
- New Demands by Customers and Government(s) Making Their Way into Contract Terms—Traceability, Animal Welfare, Food Safety, Environmental Assurance

# U.S. Hog Marketing Contract Study\*

Table 1  
Percent of U.S. Hogs Sold Through Various Pricing Arrangements,  
January 1999-2006\*

|  | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|--|------|------|------|------|------|------|------|------|
| <b>Hog or meat market formula</b>  | 44.2 | 47.2 | 54.0 | 44.5 | 41.4 | 41.4 | 39.9 | 41.8 |
| <b>Other market formula</b>  | 3.4  | 8.5  | 5.7  | 11.8 | 5.7  | 7.2  | 10.3 | 8.8  |
| <b>Other purchase arrangement</b>  | 14.4 | 16.9 | 22.8 | 8.6  | 19.2 | 20.6 | 15.4 | 16.6 |
| <b>Packer-sold</b>   |      |      |      | 2.1  | 2.2  | 2.1  | 2.4  | 2.6  |
| <b>Packer-owned</b>  |      |      |      | 16.4 | 18.1 | 17.1 | 21.4 | 20.1 |
| <b>Negotiated - spot</b>   | 35.8 | 25.7 | 17.3 | 16.7 | 13.5 | 11.6 | 10.6 | 10.2 |
| *2006 data were reported to USDA voluntarily; 2002 through 2005 data are based on USDA Mandatory Reports; 1999-2001 are based on industry surveys by the University of Missouri. |      |      |      |      |      |      |      |      |

Non-negotiated or non-spot purchases in January 2006 accounted for 89.8% of the purchases of market hogs included in the price reporting data. The 2005 study showed 89.4%; the 2004 study showed 88.4%; the 2003 study showed 86.5%; the 2002 study showed 83.3%; the 2001 study showed 82.7%; the 2000 study showed 74.3%; the 1999 study showed 64.2%; and the 1997 study showed 56.6% were non-negotiated transactions.

\* Grimes and Plain, University of Missouri Dept of Agricultural Economics Working Paper No. AEWP 2006-01  
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